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SPOTLIGHT

Savills Research

Infrastructure Levy: Impact on Planning Gain

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How will a new consolidated Infrastructure Levy work in principle?

The Planning White Paper proposes abolishing Section 106 (S106) and the Community Infrastructure Levy (CIL) and replacing them with a consolidated Infrastructure Levy (IL).

As set out, this is presented as simply a question of replacing existing planning obligations and developer contributions with a new approach more directly linked to land value capture. But implementing it will be complex. A smooth transition will be crucial to avoid disrupting the provision of new local services and affordable housing.

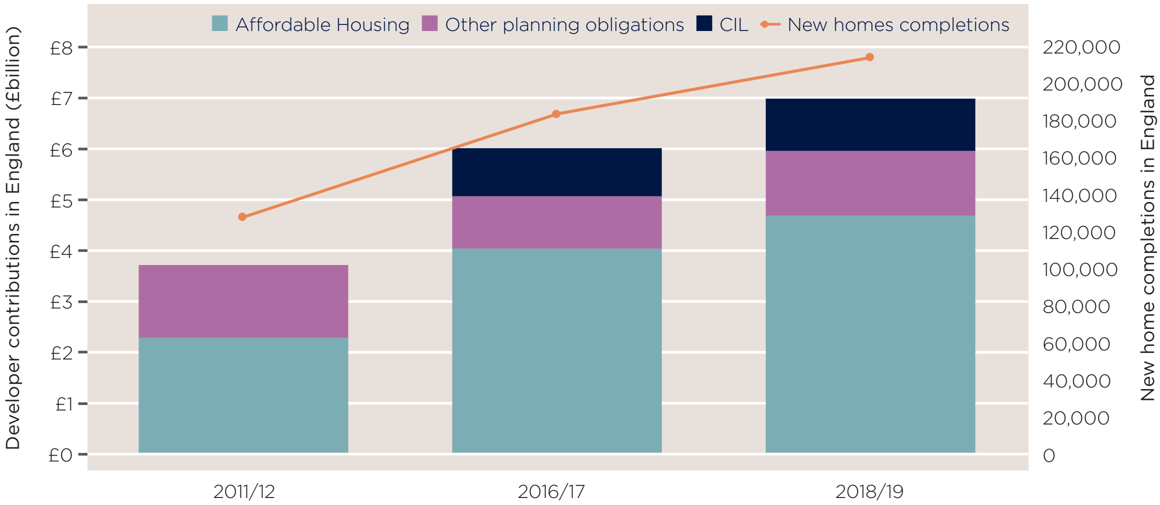
Capturing planning gain

Under the proposals, the government is seeking to use the new IL to capture a greater share of the uplift in land value when a site is granted planning permission, the so-called planning gain, to bolster infrastructure funding and delivery.

The White Paper suggests that the current system captures 25% to 50% of planning gain through developer contributions. In 2018/19, developer contributions amounted to c.£7 billion, made up of £5 billion in affordable housing, £1 billion in CIL and a further £1 billion in other S106 obligations.

Our calculations agree that around 50% of planning gain was captured via developer contributions once the costs of site remediation and enabling were factored in (see the 2019 HBF Housing Market Intelligence Report). The remaining uplift incentivises land supply and market activity, for the landowner to release the site from its existing use and for the developer to take on the market risk involved in planning and site enabling.

Figure 1 Developer contributions and housing completions



Source: MHCLG

Infrastructure costs and existing use value

The Planning White Paper proposes setting the IL at a flat percentage of the final development value. While the paper acknowledges that land value capture is dependent on both location and previous land use, a levy based purely on development value appears to disregard the very substantial differences in costs between sites in different locations, of different sizes, and with different existing use values and remediation requirements.

The cost of developing a site that is located near to existing infrastructure, for instance, is generally much lower than for more remote sites. A larger site might need to provide roads, schools, and healthcare facilities that would be unnecessary on a small infill site. The flexibility of S106 allows and accounts for this variation; a fixed levy does not.

Often, brownfield sites have a higher existing use value than greenfield land. And the cost of preparing brownfield land for development is often higher than for greenfield, as developers must remediate any ground contamination and demolish or remove any existing structures that won't form part of the final development. Accounting for such differences will be important to ensure that such sites are not rendered unviable by the IL. Such an outcome would conflict with another priority of the White Paper, that the development potential of brownfield land is maximised, while protecting the countryside.

KEY POINTS

Developer contributions capture 50% of planning gain, accounting for site remediation and enabling. The remaining uplift incentivises land supply.

An Infrastructure Levy based purely on development value appears to disregard the differences in costs between sites in different situations.

Charging the levy at the point of occupation eases the burden on developers' cashflow compared to now.

In areas where most development falls below the minimum threshold, there will be little funding for local infrastructure.

In 2018-19, 49% of affordable delivery was through Section 106. It is unclear how these proposed changes will impact affordable housing delivery.

Timing of payments

The White Paper proposes charging the IL at the point of occupation. This would ease the burden on developers' cashflow compared to the current system: CIL is levied primarily at the start of construction and, in some cases, locally identified trigger points thereafter. With S106, affordable housing contributions tend to be paid with the first instalment by the registered provider on-site start and then at locally identified trigger points. But it is unclear exactly what is meant by the point of occupation. On an office development, it is not clear whether this is the start of a lease to an occupier, or whether it allows for fitting the building out. On a residential scheme, is the levy on each home to be paid piecemeal as each one is purchased or after all the homes have been sold? If the latter, how would a multi-phase scheme be treated?

Alternatively, will the development value be assessed and determined at the point of the planning permission and the IL only charged on the point of occupation? Will the IL rate be the one that applied on grant of planning or the one that applies at point of occupation? Values, build costs and, perhaps, the minimum threshold, may all have changed substantially over that time on a large scheme. These issues of timing all feed into a developer's appraisal of a scheme.

Value threshold and other exemptions

The paper also proposes a value threshold for sites, below which no levy will be charged. It appears that government intends to form this threshold based on average build costs and a 'small allowance' for land (per square metre of development). The IL would be charged on any value that exceeds the threshold. If following this approach, it is important that the threshold reflects the changes in build costs over time.

It is unclear how the 'allowance' for land would be calculated or what it might represent. For greenfield development, it might be logical to set this 'allowance' at agricultural value (existing use value), although this varies across the country for different types of land. The IL would then be charged on a proportion of the uplift between agricultural value and development value. It will be important for this to leave enough value to motivate the landowner to release that land for development and to incur the costs of planning.

For brownfield land it is harder to envisage what the 'allowance' might represent. The existing use value may be substantial and the IL may represent an additional barrier to redevelopment, diminishing an already small value uplift. Or the land value may be mostly attributable to its potential redevelopment value, its previous use having become redundant, in which case there may be a substantial uplift in value to be realised through development.

It is intended that the IL will be collected and spent locally, funding on-site affordable housing and infrastructure. In areas where much of the development may fall below the minimum threshold, there will be little funding for infrastructure.

The White Paper proposes self and custom-build development should be exempt from IL. It is possible this exemption might encourage more self and custom build. The CIL exemption for self and custom build should provide a precedent as to how much flexibility developers must offer to buyers for a scheme to qualify as custom build.

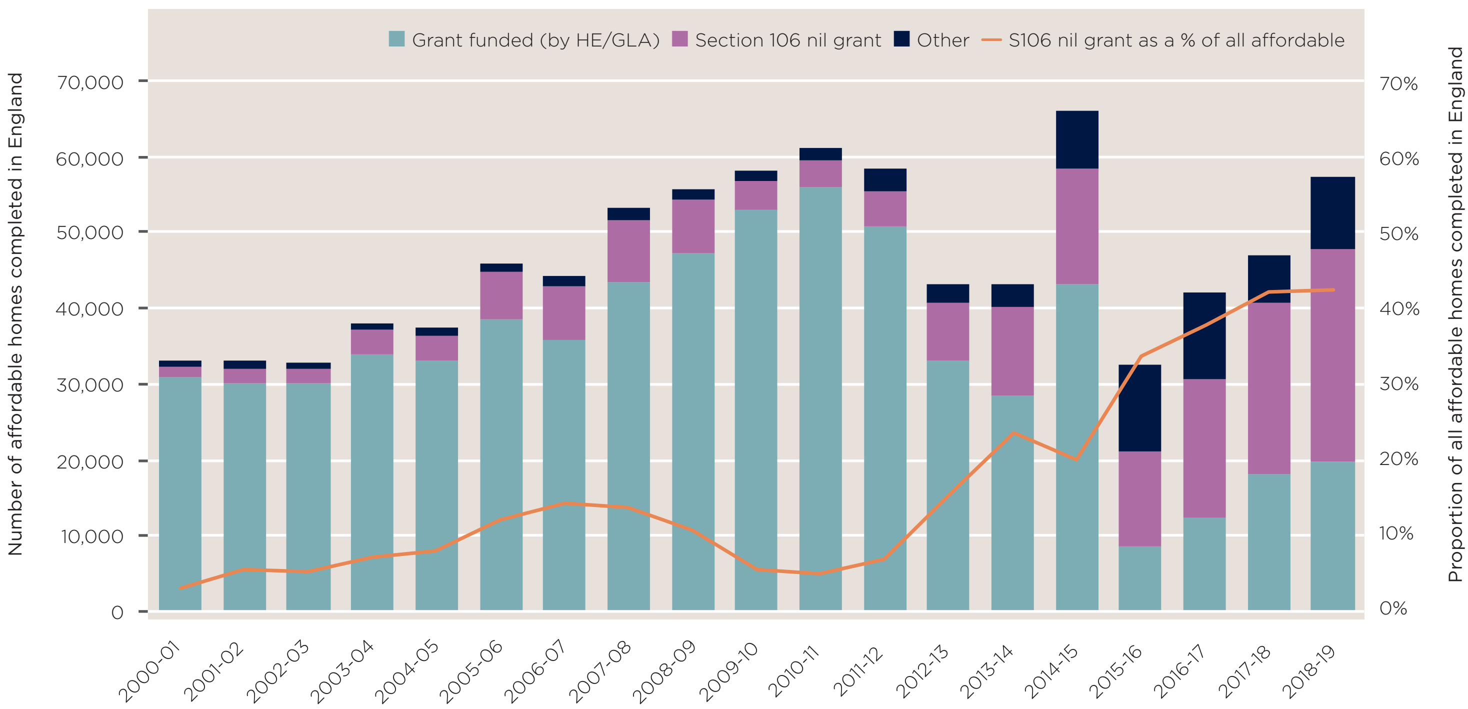
The Planning White Paper included proposals for sites under 40 or 50 homes to be exempt from providing affordable housing. It is not clear whether the same size threshold will apply to IL contributions. Or exemptions for affordable housing schemes, which are currently exempt from paying CIL.

Developer certainty

Housebuilders often call for certainty around developer contributions. If the amount of S106 affordable housing required is known, then this will be factored into the assessment of value, protecting their profit margin. If there is any doubt, then it is harder to assess the right bid for land and some may be more optimistic than others about their ability to agree a lower affordable housing contribution. This could result in housebuilders paying too much for the land and negotiating a lower affordable contribution later on viability grounds. Or it means housebuilders paying too little and the landowner refusing to release the land.

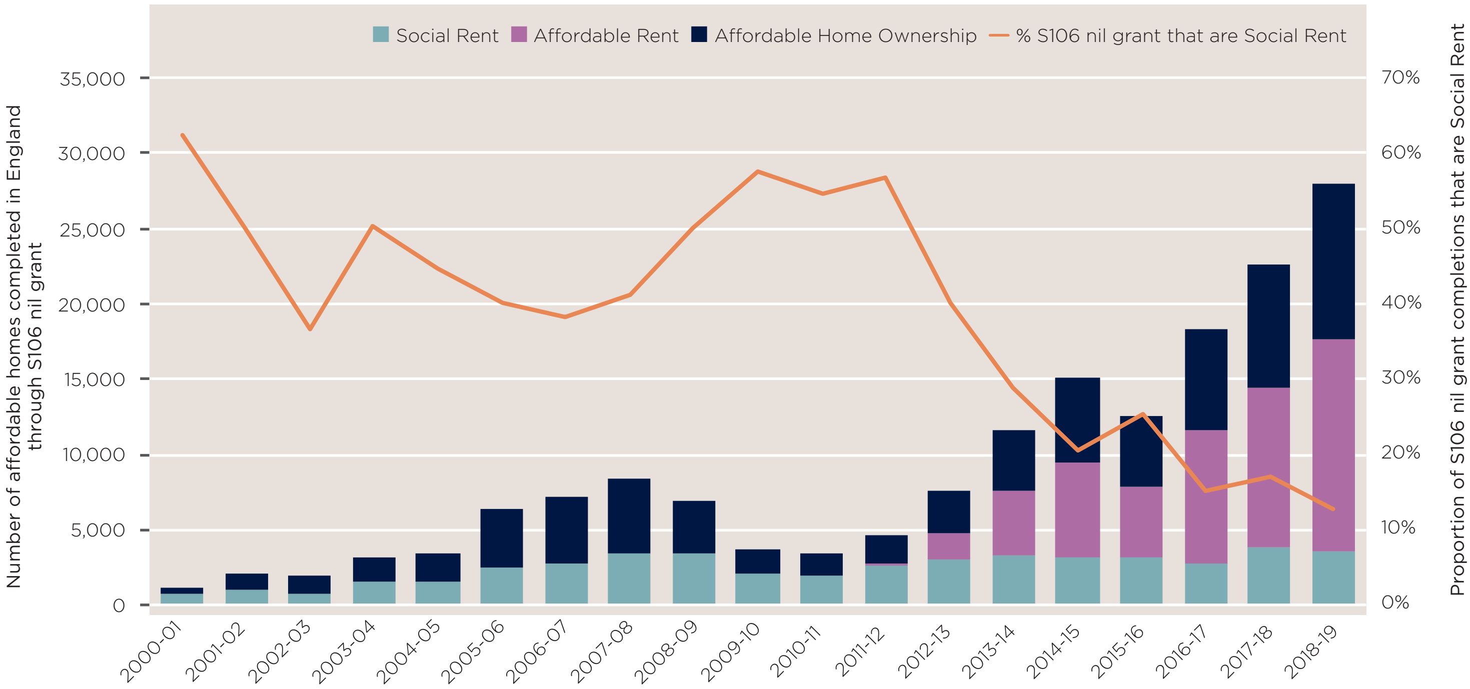
Under the White Paper proposals, IL is a fixed proportion of development value. If a site's value declines, the IL due goes down proportionately, reducing the impact on developer profit.

Figure 2 Grant funded affordable housing delivery and funding per annum



Source: MHCLG

Figure 3 Tenure of affordable housing delivered through Section 106 (S106)



Source: MHCLG (*Affordable Rent includes other discounted rental tenures)

However, if revenues are higher than expected, the IL captures a proportion of the uplift. This should reduce the risks developers face.

Other changes

The White Paper proposes that the IL would cover all use classes. This will increase the level of land value capture from commercial developments, such as offices, which do not currently need to provide affordable housing. This difference has been the deciding factor for some sites in central London as to whether they should come forward to provide offices or housing.

The impact on affordable housing delivery

In the short term, the government is proposing no affordable housing requirement for sites under 40-50 units in order to support small and medium housebuilders impacted by Covid-19. The government is also proposing to introduce First Homes, new homes sold with a discount of at least 30% of market value and with local authorities to have the discretion to increase the discount to 40% or 50%.

The paper proposes that 25% of all affordable housing units are to be provided through First Homes, as a priority over other forms of Affordable Home Ownership. Savills Research has published a more detailed note on the issues raised by First Homes here.

Under the new IL, it is intended that the delivery of on-site affordable housing remains at least at current levels. Local authorities will be able to use the IL to secure affordable housing and have more discretion over tenure mix of on-site provision.

In recent years, an increasing volume of affordable housing delivery has been through Section 106 (S106). In 2018-19, 49% of affordable delivery was through S106, in contrast to previous years when grant funding supported the vast majority of affordable housing delivery.

The most heavily subsidised affordable housing is Social Rent. Most homes for Social Rent are delivered through S106: in 2018/19, ten times as many Social Rent homes were delivered through S106 nil grant compared to delivery through grant funding. The number of Social Rent homes delivered through S106 has remained relatively constant whilst volumes of grant funded Social Rent homes have dropped off in recent years.

This raises questions about how these proposed changes will impact affordable housing delivery, specifically the delivery of Social Rent homes both during the transition period between the two systems and the longer term under the new IL.

Uncertainty around the details on the IL and its impact on affordable housing delivery highlights the need for larger scale and longer term grant funding for affordable housing.

As part of the proposed IL, developers would still be required to deliver affordable housing of a range of tenures for sale to registered providers. Developers would offset the difference between the open market sale value of those homes and their value as affordable homes from their IL liability.

This creates an incentive for them to deliver affordable housing. In the event of a weakening market, the White Paper proposes that local authorities could flip a proportion of affordable homes back to the developer to sell on the open market. However, in a weak market with falling development values, it is unlikely that developers would flip units into market sale in challenging market conditions.

The Planning White Paper also proposes allowing local authorities to borrow against future IL receipts to fund infrastructure that could help bring forward large-scale development. This would increase local authorities' role in the development process, making them more active development partners.

There is a risk this method could give local authorities greater exposure to the performance of the wider property market.

However, it has been shown to work previously by the Milton Keynes Partnership. There, the local authority borrowed from central government against future receipts to fund infrastructure, which they repaid through a roof tariff on the resulting homes.

This approach seems to suggest government intends for local authorities to take on responsibility for delivering the infrastructure funded by the IL, as there would no longer be any obligation for the developer to do so via a S106 agreement. Many local authorities do not currently have the expertise necessary to take on large-scale infrastructure delivery. Those authorities would either need to recruit or contract out these projects.

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